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SUBJECT: Global Financial Meltdown Dissolves Mongolian Resistance to Mining Projects

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Ref: A) ULAANBAATAR 495, B) ULAANBAATAR 474, C) ULAANBAATAR 382

11. (SBU) SUMMARY: The global financial crisis and steep declines in commodity prices are threatening Mongolia's aspirations to become a mining power. However, the crisis might be helping the new government and parliament overcome the crippling inertia that has afflicted them from 2006 up through the summer 2008 election, and the parties now appear committed to moving forward with legislation and with striking deals on mega-mining projects. The President of Mongolia has publicly backtracked from demands for uncompensated state equity in major projects and has called for commercially viable deals to be struck, removing fears of expropriation. However, as welcome as this response to the new reality is, it has led Mongolians to an almost panic-driven desperation to strike deals. Without the proper caution, flawed, unsustainable deals are likely. Post and other international representatives have advised government leaders to take a more balanced, reasoned, and professional approach that avoids negotiating deals from the peaks and valleys of the boom and bust cycles that routinely afflict commodity markets. We will report septel on the response of private western firms to the current situation. END SUMMARY.

Reality Bites Mongolia

12. (SBU) In the 2008 pre-election environment, Mongolia appeared just steps away from becoming a global mining giant. Copper prices were at record highs, Mongolia's premiere Erdenet copper mine could not sell its product fast enough to China, and the GOM had a surplus of nearly USD 1 billion. Giant firms such as Rio Tinto, Peabody Energy, BHP Billiton, Areva, Xstrata, and CVRD, were constantly knocking at Mongolia's door. But the Mongolian government and

public were just not biting. The standard argument went that Mongolia was sitting on fabulous, un-tapped copper, gold, coal, molybdenum, zinc, and uranium deposits, and because prices were high and likely to stay there because of ever buoyant China, Mongolia could demand whatever it wanted. Financing of projects, price fluctuations, and downturns in demand were non-issues because prices were never coming down. Of course, prices for copper tanked, Mongolia's available exchange reserves and budget surpluses are being cannibalized to satisfy prior spending commitments, and companies once intent on entering the Mongolian market have turned away for lack of financing. (Note: See ref A for a broader perspective on the impact of the global financial crisis on Mongolia's economy, and refs B and C for corporate perspectives on and approaches to working within Mongolia's business environment. End note.)

13. (SBU) In response to these reverses, the government -- at all levels -- and the public seem to have had a dramatic change of heart regarding mining policy as it affects the mega-projects. Gone is the open infighting among the PM, Ministries, State Great Hural (SGH, the parliament), President, and public, replaced by calls for deals ASAP under apparently reasonable terms, through a properly authorized process with a clear trail of responsibility and achievable goals.

PM Punts to Parliament, but Still Works the Issue

14. (SBU) After September's successful formation of a coalition government, Prime Minister Bayar placed mining policy and regulation firmly under the aegis of the newly minted Ministry of Mining and Energy (MoME), which then strategically recused itself from public participation in the formulation and passage of amendments to the

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2006 Minerals Law. More specifically, the SGH is addressing the mining issue through a Minerals Working group composed of members of the coalition and one independent MP, former Minister of Foreign Affairs S. Oyun.

15. (SBU) The Bayar government seemingly punted responsibility for striking deals in order to avoid risking another embarrassing and bruising fight with the SGH over legislation and investment agreements that the SGH has deemed its proper province. Senior Ministry officials have quietly observed that earlier attempts to clarify state ownership issues, obtain advance payments on mining projects, and close investment agreements failed because the GOM had failed to obtain public and SGH consensus on appropriate tactics. The 2006 law also specifies that the SGH has final approval on any contract for a strategic mining project. These officials have informed us that the ministry will advise the SGH upon request but will assume no formal role at this point in either the legislative or deal-making process unless and until the SGH authorizes them to do so. (Note: As observed by senior officials, if the GOM were brought back into the legislative process to draft a bill, then the entire amendment exercise would have to undergo the long and drawn out ministerial, cabinet, state security review processes, and the time for that sort of process, given Mongolia's pressing development and budget needs, is just not available. End Note.)

16. (SBU) However, waiting in the wings does not mean that the PM and his cabinet have no opinion on how they would like to see these issues progress. The government wants immediate movement on both the amendments and the investment agreements on the Rio Tinto (RT)/Ivanhoe Oyu Tolgoi (OT) copper-gold project and the Tavan Tolgoi (TT) coal deposit. Claiming that the PM shares and promotes these views, MoME officials see no reason to halt development just because legislation has not been completed. They argue that the standing 2006 Minerals Law allows the state to conduct negotiations, even if the new amendments are not passed or are delayed. The key is to get talks going and deals signed ASAP.

17. (SBU) Assuming that SGH will provide direction on the amendments and authorize negotiations, MoME officials are considering how to conduct talks with RT/Ivanhoe on OT and with other parties on TT. In their opinion (and the opinion of longtime observers of the

Mongolian mining scene), Mongolia has suffered from a lack of world-class expertise at the negotiating table. Past negotiations have pitted woefully amateurish Mongolians against the deeply skilled agents that corporations like RT can bring to the table. (Note: RT, Ivanhoe, Peabody, the World Bank, the Asian Development Bank, and this post agree with the concerns of these officials and have urged the GOM to professionalize the process. It is only within the last three months that we have obtained traction on this issue. End note.) Realizing this deficit, senior officials have quietly sought professional, experienced help to strike agreements. They have been trying to acquire assistance quietly because others within and outside of the GOM remain ambivalent about the need to use professionals to negotiate deals on OT, TT, etc. The GOM, SGH members, and other sources attribute resistance to:

-- Ignorance among NGOs, politicians, and the public about what such presumably expensive advisors would do that the Mongolians cannot do themselves, and an associated fear of having to explain to the public why the GOM needs to pay so much for expertise. (Note: Even senior officials, who should know better and who support this process, are shocked to learn that quality advice will cost at least USD 2 million and probably more.)

-- Pride in what Mongolians think they can do, and the flipside that hiring help is a sign of Mongolian weakness.

-- Fear of the transparency that would accompany professionalizing

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the process among corrupt politicians and business people who have presumably benefited from past opaque Mongolian deal-making methods.

Parliament Flexes its Muscle

18. (SBU) Because the PM deferred to the SGH on amending the 2006 Minerals law, the SGH somewhat suddenly found itself responsible for crafting an acceptable draft. In September, SGH Speaker Demberel officially sanctioned a new Mining Amendments Working Group (WG), which in composition reflected the coalition-led government and the new, younger demographic of the SGH. The old-guard steeped in socialist tradition was allowed to lead the WG: MP Badamsuren, a former director of mining policy at the now defunct Ministry of Trade and Industry and a long-serving director of the Russian-Mongolian state-owned Mongolrosvetment mining concern, chairs the group. Joining him on the WG, however, are several new MPs from the ruling Mongolian People's Revolutionary Party's (MPRP's) youthful centrist business wing, some old-line Democratic Party (DP) MPs known for their support of mining in general and western involvement in particular, and the independent MP Ms. Oyun, highly respected by the ruling MPRP party as fair and knowledgeable when it comes to mining issues. The WG was specifically tasked with drafting amendments and recommending investment agreement strategies for OT, if not other mega-projects, by November 15.

19. (SBU) By late October, the WG had apparently concluded that Mongolia needed deals more than it needed amendments, which they believed had become nothing more than time-wasting, controversial distractions. Oyun specifically observed that the state could reasonably and non-controversially acquire substantial equity over 20 to 30 years on mining assets with 100 years or more of reserves -- more than enough time for private firms to recover costs and make excellent profits. Given this and the fact that SGH-approved deals on OT and TT would have the force of law, the WG formally proposed that the SGH:

-- Issue a formal resolution that the GOM negotiate investment agreements immediately with RT/Ivanhoe on OT so that projects might start as early as summer 09. (Note: There is less eagerness to move quickly on TT, as strong differences on how to proceed linger. End note.)

-- Issue a formal resolution that the GOM prepare a revised set of amendments for the 2009 spring SGH session following the normal amendment/drafting process in which the relevant ministry prepares a

draft that will be vetted through the ministerial and cabinet review processes. (Note: The idea here is that these amendments would codify into law the terms set out in separate investment agreement(s). End note.)

¶10. (SBU) The WG proposals have garnered substantial support but some resistance remains. The ruling MPRP seems on board with the WG, at least publicly, as we have heard no dissent from MPRP MPs or MPRP-linked officials. As the Bayar Government wants to move ASAP on projects, this apparent support is to be expected.

¶11. (SBU) On the surface, the DP accepts the proposals with minimal dissent. A senior DP parliamentarian told post that only two DP MPs have rejected the WG proposals for what he describes as "bitterly personal," non-policy reasons. However, other DP members express some doubts. A DP member of the WG believes that the resolutions will pass, but suggests that DP inter- and intra-party politics may affect the execution of the investment agreement proposals. In the run-up to the June 08 elections, the DP led the calls for state equity and participation and those currently silent voices are still lurking. The DP MP argues that these DP members still do not

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understand why the GOM should not own the mine, and that complaints to this end may drive other DP MPs back to supporting "stupid, populist positions" that will cause further costly delays.

¶12. (SBU) The same DP MP also argues that DP intra-party politics might erupt. Most DP members agree that getting projects up and running is essential for the nation and for honoring DP election promises, but there is a group of the DP that sees accomplishing these ends through an MPRP-led coalition as diminishing the DP's role as a viable opposition party. While the individual members might get credit for solving some problems, the party would look like nothing more than a junior stooge for the MPRP; and so, DP MPs may ultimately have to decide between the party and their own interest in remaining in the SGH. (Note: See ref C for a full assessment of the how the DP and MPRP intended to respond to mining issues in the immediate post-election environment. End note.)

Don't Forget the President

¶13. (SBU) In the run-up to the June 2008 elections, President Enkhbayar called for state ownership of strategic deposits such as OT and TT. The Minerals law of 2006 allowed the state to acquire up to 34 percent of privately developed deposits, like OT, and 50 percent of those deposits discovered with GOM funds, such as TT. However, Enkhbayar, in a move widely seen as pandering to populist impulses among the electorate, called for the state to take at least 51 percent of any deposit it deemed strategic, apparently without compensation to the legal mining license holder. As the Mongolian President has the power to veto SGH legislation, including deals on OT and TT, the President's views impeded progress on reaching consensus.

¶14. (SBU) Post-election, Enkhbayar has turned 180 degrees on mining policy. In a recent address to the SGH, he disavowed the pre-election positions. Mongolia, he claimed, must quickly move on the projects, and state ownership desires must not impede that goal. A deal should be struck with RT and Ivanhoe on Oyu Tolgoi ASAP, and state interests in gaining equity stakes can be accomplished over time. What he would like is for RT and Ivanhoe to agree to an initial 34 percent, which the GOM would pay for out of revenues from the mine and a commitment from the private owners that the GOM could acquire an additional 17 percent of the project over 25-30 years, again using its shares of OT revenues to buy its stake.

¶15. (SBU) Most industry and some GOM observers appreciate Enkhbayar's conversion because it relieves pressure to pursue policies that can advance mining in Mongolia. They attribute this change to his realization that his populist stance was unsupportable in the current economic environment. That said, they now wish Enkhbayar would "shut up." In their opinion, he can continue to argue around the edges, but he has little else to offer other than his acquiescence to what the SGH puts before him, as long as it achieves

the aims that he has promoted from his bully pulpit.

Public Attitudes: NGOs are Not "The People"

¶16. (SBU) At this point it is hard to gauge the public's reaction to all the chatter. However, it is important to separate the public's reaction from that of the NGO's. Long time observers of the mining scene and Mongolian politics sense that the public is ready for action on projects, and will accept plans and deals that have been explained to them in an open, transparent way -- even controversial ones that back away from 51 percent state ownership. The challenge for the government is to engage the public in this manner, something that it has resisted doing consistently over the last 20 years of reform. MP Odkhuu, among others with whom we have spoken, has

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related that his constituents want action on mining, because they want jobs and the development that comes with mining. Public reaction to the WG proposals seems muted, with none of the street protests or "screaming" NGO leaders that have accompanied past announcements of movement on mining policy.

¶17. (SBU) Although they did not instigate the riot, some of the more radical, obstreperous from the NGO community were not shy in attempting to take advantage of the event, especially those seen on TV exhorting the crowd to take action against the MPRP. However, their apparent failure to move the wider public to both their views and against their subsequent incarceration seems to have dampened the enthusiasm of other NGO rabble rousers for taking to the street. Other observers argue that some of these NGOs have signaled that they would like to join the debate more formally, calmly, and responsibly than they have in the past.

Comment: Getting off the Pendulum

¶18. (SBU) Among our Mongolian interlocutors, the current environment has led to a near panic to get something done, no matter the cost. "ASAP," "immediate," and "now" are the words most often heard, and they often accompany plaintive, worried queries if the western firms are still interested or can afford to invest. If the Mongolians make a panic-driven deal based on low commodity prices and capital shortages, such a deal could well be repudiated several years down the road when conditions improve, and the country will be right back to where it was in early 2008, with political gridlock and development halted mid-stream. We, along with other like-minded members of the international community, are advising the Mongolians that deals on mines ought not to be negotiated from the peaks and valleys of boom and bust cycles that routinely afflict commodity markets. Finding the sweet spot between the peak and the valley for mining projects with 30 or more years of life in them will more likely come from the rational assessment of a properly authorized, well-funded Mongolian negotiating team, supplemented by world-class professional advisors, and whose deliberations are open to public and legislative review.

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